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September 1, 2006

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Jane Lewis-Raymond, Esquire  
Piedmont Natural Gas Company, Inc.  
4720 Piedmont Row Drive  
Charlotte, NC 28210

Re: Report of Office of Regulatory Staff Review of Piedmont Natural Gas Company, Inc.'s Monitoring Report Under **CHAPTER 5, TITLE 58 CODE OF LAWS OF SOUTH CAROLINA, ARTICLE 4** ("the Natural Gas Rate Stabilization Act" or "the Act") for the Twelve-Month Period Ending March 31, 2006

**Docket No. 2005-125-G**

Gentlemen:

The Office of Regulatory Staff (hereafter "ORS"), in accordance with the Natural Gas Rate Stabilization Act, S.C. Code Ann §§ 58-5-400, et seq., conducted a review of Piedmont Natural Gas Company, Inc.'s (hereafter "Piedmont" or "the Company") Monitoring Report for the twelve-month period ending March 31, 2006. The said review was conducted for the purpose of determining the Company's compliance with Section 58-5-430 and Section 58-5-440 of the Act.

The Company reported in its March 31, 2006, Quarterly Report a Rate of Return of 6.89%. The Company's calculation of additional revenue required to restore Return on Equity to the 12.60% level authorized in its most recent rate case (Order No. 2002-761 issued in Docket No. 2002-63-G on November 1, 2002) was an additional \$11,249,086 comprised of a \$10,387,852 Margin Increase accompanied by an \$861,234 adjustment for Demand Cost Under-Recovery.

Based upon its review, the Office of Regulatory Staff is proposing certain adjustments (see Schedule 2) to reported amounts to bring the report into conformance with Section 58-5-430 and Section 58-5-440 of the Act.

The Office of Regulatory Staff calculated the Company's Rate of Return and Return on Equity as 7.87 and 8.55%, respectively, after accounting and proforma adjustments. Therefore, in accordance with the guidelines of the Act, the Company is entitled to an increase in rates sufficient to achieve a Return on Equity equaling 12.60% (authorized in their most recent rate case). Accordingly, ORS recommends that the Company's requested increase be reduced by \$1,721,337 to a net increase in revenues of \$9,527,749. This increase is comprised of a recommended margin increase of \$8,670,000 increased by a Demand Cost Under-Recovery of \$857,749. After the proposed increase, the Company's Rate of Return and Return on Equity will be 10.32% and 12.60%, respectively.

The following is a summary of the Dockets relative to the Company's most recent rate adjustments:

Date of Order	Docket Number	Amount Requested	Amount Granted	Rates of Return	
				Rate Base	Common Equity
11/07/95	95-715-G	\$ 8,827,414	\$7,807,207	10.77%	12.50%
11/01/02	2002-63-G	\$15,336,891	\$8,381,220	10.39%	12.60%
10/21/05	2005-125-G	\$ 4,672,048	\$1,387,964	10.34%	12.60%

The following is a description of Schedules prepared by ORS as a result of its review of the Company's filing:

**Schedule 1** presents the Company's Operating Experience, Rate Base and Rates of Return for the year ended March 31, 2006, and the accounting and pro forma adjustments which are necessary to correct or normalize the Company's operations both before and after the effect of the requested increase. Utilizing the per books rate base of \$221,173,969 and income of \$15,244,738, ORS computed a Rate of Return on per book operations of 6.89% with an accompanying Return on Equity of 6.94%. Accounting and pro forma adjustments increased Operating Income to \$17,178,477 and decreased rate base to \$218,243,301. The Return on Equity computed by ORS after accounting and pro forma adjustment was 8.55%. After the adjustment for the proposed margin increase of \$8,670,000 and adjustments for an increase for Demand Cost Under-Recovery of \$857,749, operating income increased to \$22,527,655. The Rate of Return on rate base

computed by the ORS after the adjustment for the proposed increase is 10.32% with a corresponding Return on Equity of 12.60%.

**Schedule 2** presents an explanation of the accounting and pro forma adjustments ORS considers necessary for the Company's report to conform with Section 58-5-430 and Section 58-5-440 of the Act. For comparative purposes, the adjustments of both the Company and ORS are presented.


**Schedule 3** presents the calculation of the weighted average cost of capital used by the Company in calculating its Return on Equity both before and after its proposed increase. The rate base, as shown on Schedule 1, is allocated between long term debt and equity according to the respective ratios as computed using the Company's capital structure as of March 31, 2006. The amount of total income for return necessary to cover an embedded cost rate of 6.82% on long term debt is computed to be \$5,856,640. The remainder of the total income for return of \$11,321,837 is income to common equity. Such remainder produced a return of 8.55% on common equity before the requested increase. The overall cost of capital after accounting and pro forma adjustments but prior to the requested increase is 7.87%. Such overall cost of capital equals the rate of return on rate base shown on Schedule 1.

After the proposed increase of \$8,670,000 and the Adjustments for Demand Cost Under-Recovery of \$857,749, income available to common equity increases to \$16,671,015 and return on common equity increases to 12.60%. Overall cost of capital as detailed in this exhibit equals 10.32%. Such overall cost of capital equals the rate of return on Schedule 1.

Respectfully submitted by,

  
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Jeffrey M. Nelson, Esquire

- and -

  
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Jay R. Jashinsky, CPA

Piedmont Natural Gas Company  
South Carolina Operations  
Net Operating Income and Rate of Return  
For the Twelve Months Ended March 31, 2006  
Docket No. 2005-125-G

	(1) Per Regulatory Books	(2) Accounting and Pro Forma Adjustments	(3) After Accounting and Pro Forma Adjustments	(4) Adjustments for Proposed Margin Increase	(5) Adjustments for Demand Cost Under-Recovery	(6) Total After Proposed Rates
<b><u>Operating Revenues</u></b>						
1 Sale and Transportation of Gas	\$ 218,315,544	\$ (8,157,553) (1)	\$ 210,157,991	\$ 8,670,000 (11)	\$ 857,749 (16)	\$ 219,685,740
2 Other Operating Revenues	858,857	0	858,857			858,857
3 Total Operating Revenues	219,174,401	(8,157,553)	211,016,848	8,670,000	857,749	220,544,597
<b><u>Operating Expenses</u></b>						
4 Cost of Gas	151,604,313	(12,904,079) (2)	138,700,234		853,351 (17)	139,553,585
5 Operations and Maintenance	30,462,587	185,455 (3)	30,648,042	44,453 (12)	4,398 (18)	30,696,893
6 Depreciation	10,819,056	630,075 (4)	11,449,131			11,449,131
7 General Taxes	6,521,305	93,909 (5)	6,615,214			6,615,214
8 State Income Taxes	61,749	842,383 (6)	904,132	431,278 (13)		1,335,410
9 Federal Income Taxes	4,920,414	1,068,713 (7)	5,989,127	2,867,995 (14)		8,857,122
10 Amortization of Investment Tax Credits	(60,805)		(60,805)			(60,805)
11 Total Operating Expenses	204,328,619	(10,083,544)	194,245,075	3,343,725	857,749	198,446,549
12 Net Operating Income	14,845,782	1,925,991	16,771,773	5,326,275	0	22,098,048
13 Interest on Customers' Deposits	(110,391)		(110,391)			(110,391)
14 Amortization of Debt Redemption Premium	(14,339)	(534) (8)	(14,873)			(14,873)
15 Allowance for Funds Used During Construction	460,324		460,324			460,324
16 Customer Growth	63,362	8,282 (9)	71,644	22,903 (15)		94,547
17 Net Operating Income for Return	\$ 15,244,738	\$ 1,933,739	\$ 17,178,477	\$ 5,349,178	\$ 0	\$ 22,527,655
<b><u>Original Cost Rate Base:</u></b>						
18 Plant in Service	\$ 344,615,411		\$ 344,615,411			\$ 344,615,411
19 Accumulated Depreciation	(124,515,520)		(124,515,520)			(124,515,520)
20 Net Plant in Service	220,099,891		220,099,891			220,099,891
Add:						
21 Construction Work in Progress	9,349,299		9,349,299			9,349,299
22 Materials and Supplies	21,006,145	9,583 (19)	21,015,728			21,015,728
23 Cash Working Capital	5,596,092	(2,940,251) (10)	2,655,841			2,655,841
Deduct:						
24 Customers' Advances	3,599		3,599			3,599
25 Customers' Deposits	3,441,239		3,441,239			3,441,239
26 Accumulated Deferred Income Taxes	31,058,898		31,058,898			31,058,898
27 Unclaimed Funds	373,722		373,722			373,722
28 Original Cost Rate Base:	\$ 221,173,969	\$ (2,930,668)	\$ 218,243,301			\$ 218,243,301
29 Rate of Return	6.89%		7.87%			10.32%
Return on Equity	6.94%		8.55%			12.60%

**Piedmont Natural Gas Company**  
**South Carolina Operations**  
**Explanations of Accounting and Pro Forma Adjustments**  
**Twelve Months Ended March 31, 2006**  
**Docket No. 2005-125-G**

Schedule 2

Line No.	Description	Per Piedmont	Per ORS
1	<b><u>Operating Revenues - Sale and Transportation of Gas</u></b>		
	Piedmont proposes to decrease revenues to the going-level basis. ORS agrees with this adjustment	\$ (8,157,553)	\$ (8,157,553)
	<b><u>Total Operating Revenues - Sale and Transportation of Gas</u></b>	<b><u>\$ (8,157,553)</u></b>	<b><u>\$ (8,157,553)</u></b>
2	<b><u>Cost of Gas</u></b>		
	Piedmont proposes to decrease cost of gas to the going-level basis. ORS agrees with this adjustment	\$ (12,904,079)	\$ (12,904,079)
	<b><u>Total Cost of Gas</u></b>	<b><u>\$ (12,904,079)</u></b>	<b><u>\$ (12,904,079)</u></b>
3	<b><u>Operations and Maintenance Expenses</u></b>		
a.	Piedmont and ORS propose to increase payroll costs to the going-level basis. The Company and ORS annualized the actual salaries and wages expense at March 31, 2006. The Company and ORS's calculation disallows officer salary increases during the test period in conformance with PSC Order No. 2002-761, November 1, 2002	\$ 760,993	\$ 760,993
b.	Piedmont and ORS propose to decrease expenses for the Salary and Payroll Investment Plans. The Plan allows participants to defer a portion of their base salary, and the Company matches a portion of the participant's contribution.	(6,404)	(6,404)
c.	Piedmont and ORS propose to correct pension costs included in the Original Filing.	(41,068)	(127,483)
d.	Piedmont and ORS propose to adjust uncollectible gas cost expense. ORS has recalculated this adjustment utilizing the method recently approved in Docket No. 2006-4-G (order pending). This removes uncollectible gas cost expense from base rates and records the amount in account # 253.04.	497,551	(370,192)
f.	Piedmont and ORS propose to decrease expenses for allocations to non-utility activities.	(22,803)	(22,803)
g.	Piedmont and ORS propose to increase expenses for the Long-Term Incentive Plan.	12,557	12,557
h.	Piedmont and ORS propose to decrease expenses for the Short-Term Incentive Plan.	(87,984)	(87,984)
i.	Piedmont and ORS proposes to decrease expenses for the MVP Incentive Plan.	(14,390)	(14,390)
j.	Piedmont and ORS propose to increase expenses for group insurance for projected costs increases.	42,726	42,726
k.	Piedmont and ORS propose to increase expenses for the Piedmont Town Center lease.	159,882	159,882
l.	Piedmont and ORS propose to decrease expenses for the South Carolina assessment fee.	(28,771)	(28,771)
m.	Piedmont and ORS propose to decrease expenses for those expenses not allowable for ratemaking purposes.	(132,676)	(132,676)
	<b><u>Total Operations and Maintenance Expense</u></b>	<b><u>\$ 1,139,613</u></b>	<b><u>\$ 185,455</u></b>

**Piedmont Natural Gas Company**  
**South Carolina Operations**  
**Explanations of Accounting and Pro Forma Adjustments**  
**Twelve Months Ended March 31, 2006**  
**Docket No. 2005-125-G**

<u>Line No.</u>	<u>Description</u>	<u>Per Piedmont</u>	<u>Per ORS</u>
<b>4</b>	<b><u>Depreciation Expense</u></b>		
	Piedmont and ORS propose to increase depreciation expense to the going-level basis using recently completed depreciation study rates.	\$ 630,075	\$ 630,075
	<b>Total Depreciation Expense</b>	<b>\$ 630,075</b>	<b>\$ 630,075</b>
<b>5</b>	<b><u>General Taxes</u></b>		
a.	Piedmont and ORS propose to increase property taxes to the going-level basis.	\$ 22,651	\$ 22,651
b.	Piedmont and ORS propose to adjust payroll tax expense.	369,304	127,139
c.	Piedmont and ORS propose to decrease franchise taxes to the going-level basis.	(63,102)	(63,102)
d.	Piedmont and ORS propose to increase other taxes to the going-level basis.	7,221	7,221
	<b>Total General Taxes</b>	<b>\$ 336,074</b>	<b>\$ 93,909</b>
<b>6</b>	<b><u>State Income Taxes</u></b>		
	Piedmont and ORS propose to adjust state income taxes (rate of 5%) to reflect the impact on income of accounting and proforma adjustments.	\$ 778,444	\$ 842,383
	<b>Total State Income Taxes</b>	<b>\$ 778,444</b>	<b>\$ 842,383</b>
<b>7</b>	<b><u>Federal Income Taxes</u></b>		
	Piedmont and ORS propose to adjust federal income taxes (rate of 35%) to reflect the impact on income of accounting and proforma adjustments.	\$ 643,515	\$ 1,068,713
	<b>Total Federal Income Taxes</b>	<b>\$ 643,515</b>	<b>\$ 1,068,713</b>
<b>8</b>	<b><u>Amortization of Debt Redemption Premium</u></b>		
	Piedmont and ORS propose to decrease net operating income for amortization of debt redemption premium.	\$ (534)	\$ (534)
	<b>Total Amortization of Debt Redemption Premium</b>	<b>\$ (534)</b>	<b>\$ (534)</b>
<b>9</b>	<b><u>Customer Growth</u></b>		
	Piedmont and ORS propose to increase net operating income to reflect anticipated customer growth (rate of .43%) following the adjustments to operating revenues and expenses.	\$ 5,241	\$ 8,282
	<b>Total Customer Growth</b>	<b>\$ 5,241</b>	<b>\$ 8,282</b>

**Piedmont Natural Gas Company**  
**South Carolina Operations**  
**Explanations of Accounting and Pro Forma Adjustments**  
**Twelve Months Ended March 31, 2006**  
**Docket No. 2005-125-G**

Schedule 2

Line No.	Description	Per Piedmont	Per ORS
10	<b><u>Cash Working Capital</u></b>		
a.	ORS proposes to reduce cash working capital to reflect the effect on operating expenses of tax accruals associated with accumulated deferred income taxes.	\$ -	\$ (2,963,433)
b.	Piedmont and ORS propose to increase cash working capital following the pro forma adjustments to operation, and maintenance expenses (rate of 12.5%) as reflected in the original filing.	142,452	23,182
	<b><u>Total Cash Working Capital</u></b>	<u>\$ 142,452</u>	<u>\$ (2,940,251)</u>
11	<b><u>Operating Revenues - Sale and Transportation of Gas</u></b>		
	Piedmont and ORS propose to increase revenues from the sale and transportation of gas for proposed margin increase before demand cost under-recovery.	\$ 10,387,852	\$ 8,670,000
	<b><u>Total Operating Revenues - Sale and Transportation of Gas</u></b>	<u>\$ 10,387,852</u>	<u>\$ 8,670,000</u>
12	<b><u>Operations and Maintenance Expenses</u></b>		
a.	Piedmont and ORS propose to increase the provision for uncollectible accounts (rate of .21272%) following the adjustments to operating revenues.	\$ 64,989	\$ 18,443
b.	Piedmont and ORS propose to increase the utility license fee (rate of .30%) following the adjustments to operating revenues.	30,969	26,010
	<b><u>Total Operations and Maintenance Expenses</u></b>	<u>\$ 95,958</u>	<u>\$ 44,453</u>
13	<b><u>State Income Taxes</u></b>		
	Piedmont and ORS propose to adjust state income taxes (rate of 5%) to reflect the impact on income of adjustments to operating revenues and expenses.	\$ 514,595	\$ 431,278
	<b><u>Total State Income Taxes</u></b>	<u>\$ 514,595</u>	<u>\$ 431,278</u>
14	<b><u>Federal Income Taxes</u></b>		
	Piedmont and ORS propose to adjust federal income taxes (rate of 35%) to reflect the impact on income of adjustments to operating revenues and expenses.	\$ 3,422,055	\$ 2,867,995
	<b><u>Total Federal Income Taxes</u></b>	<u>\$ 3,422,055</u>	<u>\$ 2,867,995</u>
15	<b><u>Customer Growth</u></b>		
	Piedmont and ORS propose to increase net operating income to reflect anticipated customer growth (rate of .43%) following the adjustments to operating revenues and expenses.	\$ 27,328	\$ 22,903
	<b><u>Total Customer Growth</u></b>	<u>\$ 27,328</u>	<u>\$ 22,903</u>

**Piedmont Natural Gas Company**  
**South Carolina Operations**  
**Explanations of Accounting and Pro Forma Adjustments**  
**Twelve Months Ended March 31, 2006**  
**Docket No. 2005-125-G**

Schedule 2

Line No.	<u>Description</u>	<u>Per Piedmont</u>	<u>Per ORS</u>
16	<b><u>Operating Revenues - Sale and Transportation of Gas</u></b>		
	Piedmont and ORS propose to increase revenue requirement for the sale and transportation of gas associated with the demand cost under-recovery.	\$ 861,234	\$ 857,749
	<b><u>Total Operating Revenues - Sale and Transportation of Gas</u></b>	<u>\$ 861,234</u>	<u>\$ 857,749</u>
17	<b><u>Cost of Gas</u></b>		
	Piedmont and ORS propose to increase cost of gas for the demand cost under-recovery using a demand cost allocation factor of 16.16%, based upon the most recent design day study.	\$ 853,351	\$ 853,351
	<b><u>Total Cost of Gas</u></b>	<u>\$ 853,351</u>	<u>\$ 853,351</u>
18	<b><u>Operations and Maintenance Expenses</u></b>		
	a. Piedmont and ORS propose to increase the provision for uncollectible accounts (rate of .21272%) following the adjustment to operating revenues.	\$ 5,339	\$ 1,825
	b. Piedmont and ORS propose to increase the utility license fee (rate of .30%) following the adjustments to operating revenues.	2,544	2,573
	<b><u>Total Operations and Maintenance Expenses</u></b>	<u>\$ 7,883</u>	<u>\$ 4,398</u>
	<b><u>Materials and Supplies</u></b>		
19	ORS proposes to adjust storage inventory vales to correct Piedmont's calculations included in the Original filing.	\$ 0	\$ 9,583
	<b><u>Total Materials and Supplies</u></b>	<u>\$ 0</u>	<u>\$ 9,583</u>



Piedmont Natural Gas Company  
 South Carolina Operations  
 Weighted Cost of Capital  
 As of March 31, 2006  
 Docket No. 2005-125-G

Description	Capital Structure	Ratio	Regulatory Per Books				As Adjusted				After Proposed Increase			
			Base Rate	Embedded Cost/Return	Overall Cost/Return	Income For Return	Rate Base	Embedded Cost/Return	Overall Cost/Return	Income For Return	Rate Base	Embedded Cost/Return	Overall Cost/Return	Net Operating Income
Long-Term Debt	620,360,494	39.35%	87,040,405	6.82%	2.68%	5,935,285	85,887,075	6.82%	2.68%	5,856,640	85,887,075	6.82%	2.68%	5,856,640
Common Equity	956,006,163	60.65%	134,133,564	6.94%	4.21%	9,309,453	132,356,226	8.55%	5.19%	11,321,837	132,356,226	12.60%	7.64%	16,671,015
<b>Total</b>	<u>1,576,366,657</u>	100.00%	<u>221,173,969</u>		6.89%	<u>15,244,738</u>	<u>218,243,301</u>		7.87%	<u>17,178,477</u>	<u>218,243,301</u>		10.32%	<u>22,527,655</u>